No. 2824

In the
United States Circuit Court of Appeals
for the Ninth Circuit

In the Matter of SOUTHERN ARIZONA SMELTING COMPANY, a Corporation, Bankrupt.

M. F. FREEMAN, as Trustee in Bankruptcy of SOUTHERN ARIZONA SMELTING COMPANY, a Corporation,

Appellant,

—vs.—

JOHN H. MARTIN, as Trustee in Bankruptcy of IMPERIAL COPPER COMPANY, a Corporation, Bankrupt,

Appellee.

REPLY BRIEF OF APPELLEE TO APPELLANT'S ADDITIONAL BRIEF.

FRANCIS M. HARTMAN,
EDWIN F. JONES,
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Tucson, Arizona.

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REPLY BRIEF OF APPELLEE TO APPELLANT'S ADDITIONAL BRIEF.

Notwithstanding the fact, as pointed out in our reply to appellant's opening brief, that appellant has not in his opening brief in his specification of errors relied upon, pointed out or specified as an error relied upon the conclusion of law of the District Court that the Smelting Company was a subsidiary, instrumentality and adjunct, etc., of the Copper Company, we have been furnished with an additional brief in the case which is confined to a consideration of the single question of the correctness

of the ruling of the District Court in its Conclusions of Law:

"That the Southern Arizona Smelting Company, a corporation, was a subsidiary of the Imperial Copper Company, a corporation, created and used by the Imperial Copper Company for its convenience in the transaction of its business; that the Imperial Copper Company was the parent corporation of said Southern Arizona Smelting Company and used said Southern Arizona Smelting Company as an adjunct, agent and instrumentality in the transaction of its business."

Upon an examination of appellant's assignment of errors (Tr. pp. 98-101) it appears that appellant has not complied with Rule 11 of this court requiring an assignment of errors to set out separately and particularly each error asserted and intended to be urged.

The only reference to this particular conclusion of law in appellant's assignment of errors is found in paragraph one (1) thereof (Tr, pp. 98-98) as follows:

"I.

"The Court erred in its conclusions of law from the Findings of Fact as made and filed herein, which said conclusions of law, so assigned as erroneous, are as follows:

'That the Southern Arizona Smelting Company, a corporation, was a subsidiary of the Imperial Copper Company, a corporation, created and used by the Imperial Copper Company for its convenience in the trans-

action of its business, that said Imperial Copper Company was the parent corporation of said Southern Arizona Smelting Company and used said Southern Arizona Smelting as an adjunct, agent and instrumentality in the transaction of its business.

'That all of the ores shipped by the Imperial Copper Company to the Southern Arizona Smelting Company, and the title thereto, as well as the title to all of the flue dust and slag dump arising from the smelting of said ores by the Southern Arizona Smelting Company remained in the Imperial Copper Company; that the contract under which said ores were so shipped by the Imperial Copper Company, and smelted by the Southern Arizona Smelting Company, constituted a bailment and nota sale; that said slag dump and flue dust is the property of the estate of the Imperial Copper Company, bankrupt, and John H. Martin, as Trustee in Bankruptcy of said Imperial Copper Company, Bankrupt, is entitled to the possession of said property; and that the estate of said Southern Arizona Smelting Company has no title or right to the said slag dump and flue dust and that said M. P. Freeman, as Trustee of said Southern Arizona Smelting Company, Bankrupt, has no right, title or interest in or to any of said property, and is not entitled to the possession thereof.' "

Appellant has not in his assignment of errors, set out separately and particularly as an error complained of, the conclusion of law of the District Court that the Smelting Company was a subsidiary, agent, instrumentality, adjunct, etc. of the Copper Company, and we

therefore contend that appellant is not entitled to raise the question in this court, especially as appellent does not in his opening brief set out separately and particularly or at all the said conclusion of law of the District Court as an error relied upon, as required by Rule 24 of this court.

However, not waiving any of our rights in this respect, we deem it our duty to our client to reply to appellant's additional brief.

The rule, as deduced from the cases cited and relied on by appellant may be stated: That the rule of distinct corporate existence will be set aside or rather disregarded in two cases: (1) When necessary to circumvent fraud; and (2) When a corporation is so organized and controlled and its affairs are so conducted as to make it merely an instrumentality or adjunct of another corporation.

The cases cited and relied upon as showing that the case at bar should not be regarded as such instrumentality will be considered in the order in which they are cited by the brief.

The first is the case of Pittsburg & Buffalo Co. vs. Duncan, 232 Fed. 584. The facts of that case are that a Receiver of a railroad company which was being administered in the District Court had purchased coal from the appellant, Pittsburgh & Buffalo Co., (an Ohio Corporation), a wholesale coal dealer in Cleveland, Ohio, to the amount of $2182.19. The Cleveland & Pitts-

burgh Coal Co., (an Ohio Corporation), which was also under receivership in the District Court, was a retail coal dealer in Cleveland and was indebted to the Receiver for freight and demurrage in the sum of $1,-453.46, and the Pittsburgh-Buffalo Co., (a Pennsylvania corporation), which was a coal mine owner and operator, was under a receivership in the Pennsylvania courts and was indebted to the Receiver in the sum of $160.96, for repairs to its cars. The receiver claimed the right to offset the indebtedness of the last named companies to him against his indebtedness to the appellant, which right the appellant denied. The court, after stating the stock ownership of the various companies, says:

"Appellant is not under the receivership. It has acted for many years past as sales agent for the two mining companies, which has been its principal business. The books of appellant and the Cleveland & Pittsburgh Company have always been kept separately, and their dealings have not been confined to the material furnished by the Jones interests, although this has constituted a large portion of their business and the principal portion of appellant's business," and decides that the facts fall far short of supporting a conclusion either that the Cleveland & Pittsburg Co (the retail dealer) was in fact appellant's sales agent or that it was so held out by appellant.

Speaking of the effect of the stock ownership and corporate control, the court, after quoting the extract contained in appellant's brief, say: "In the instant case

there is not even complete identity of ownership in fact over the three corporations involved. Their stock is not all owned by the Jones interest, individual stockholders in the different companies are not identical in amount and one of the Jones Brothers has no personal holdings in the Cleveland & Pittsburg Company. **Appellant holds no stock in either of the other corporations.**

In the case at bar the Copper Company owned all of the stock of the Smelting Company, and the latter was finaced wholly with the corporate funds of the former. Its very existence was due to a contract which binds it to do the smelting for the Copper Company at cost and five per cent on the cost of the plant. Its officers are the same, and it has no separate financial existence, its bills being paid by orders on the Copper Company and every dollar of its income being turned over to that company. Ninety-five per cent of its business consisting of work for the Copper Company which it must do at cost, and any profits which it made on outside smelting belonged to the Copper Company by virtue of its owning all the stock.

The facts in that case do not in any sense run parallel with this case and the law declared on such a state of facts can have no application here.

The appellants lay great stress on the case of In Re Watertown Paper Company, 169 Fed. 252: The bankrupt in that case (The Watertown Paper Company) was organized in 1864. Prior to 1886 its entire capital stock

was owned by Hiram Remington and Edward W. Remington and in that year the three daughters of Hiram Remington had 20 shares transferred to each of them. The Pulp Company was organized in 1887 with a capital stock of $20,000, Hiram Remington owning $10,000 and Edward Remington, $9,500 and his wife $500. The court thus states the manner in which the stock in the pulp company was paid for: "The stock of the Pulp Company was paid for by Hiram Remington and Edward Remington in the following manner: They both had credits of considerable sums upon the books of the paper company which by their direction advanced the necessary funds to the Pulp Company and charged the advancements to their accounts." After stating the various changes in the ownership of stock the court say: "It may be broadly stated that during the entire existence of the Pulp Company prior to 1905, when Taylor acquired the shares of the two companies, the ownership of their stock had been in the families of Hiram and Edward Remington and their families. But it also appears that the several stockholders had different interests in the two corporations and that some owned stock in only one corporation.

The affairs of the two companies were closely intermingled. Separate books of account were kept for the two corporations, but the business was conducted from the office of the Paper Company. The Pulp Company had no bank account, all its bills being paid by the Paper Company and charged to its account. All credits were collected by the Paper Company and credited to it, and

a certain proportion of the office expenses were charged to the Pulp Company.

The court after stating the rule of law as to a corporation which was organized as an instrumentality or adjunct, and citing authorities, say: "But the prinicples of these cases are only indirectly applicable here. **Neither the Paper Company nor the Pulp Company own any of the other's shares,** and in no sense can it be said that the Paper Company organized the Pulp Company as a department of its business."

The court then cite the case of In re Muncie Pulp Co., 139 Fed. 546, which was decided by the same court, and, after showing the facts in that case, state the difference between that case and the one they were considering. They say: "The present case is not at all like the Muncie case, nor like any of the other cases cited by appellee..... **The Paper Company did not in any legal sense furnish the money to build the Pulp Company plant. It is true that it actually advanced the funds, but it did it for the account of the Remingtons. It was merely the conduit through which the Remington money passed to meet their obligations. It does not appear that the Paper Company ever had the slightest claim—legal or equitable—to any of the stock of the Pulp Company."**

It is evident from the opinion that the fact that the Paper Company did not use any of its corporate funds to build the plant of the Pulp Company and did not have, in the language of the court, "the slightest claim —legal or equitable" to any of the Pulp Company's

stock, was the foundation of the refusal of the court in the case to hold that the Pulp Company was merely an adjunct of the Paper Company.

The facts in the case now before the court show every fact present in the Watertown case and in addition they disclose the existence of the very facts which that opinion says are controlling, and the absence of which compelled the result reached in the Watertown case.

They show that the entire plant of the Smelting Company was paid for out of the corporate assets of the Copper Company and that all of the stock of the Smelting Company was owned by the Copper Company and they further show that the Smelting Company in the same contract which provided for the erection of the plant bound itself to do the smelting for the Copper Company at cost. If this is not doing the work of an instrumentality of the Copper Company it would be difficult to imagine a state of facts which would show the use of one corporation as an adjunct by another.

It is next insisted that because the appellee or the Copper Company brought suit against the Smelting Company for a balance shown on its books that thereby in some way they are bound to admit that the Smelting Company is not an adjunct of the Copper Company. The appellee was a trustee for the creditors and he had to protect their rights in any aspect of the case. He is not required by any rule of law to rest his case on any one view of his rights. If the Smelting Company is

simply an instrumentality, he has certain rights, and if a separate and distinct corporation he has others, and he may claim both until the courts fix his rights. He would have been negligent not to present his claim as such, and worse than negligent if he failed to call to the Court's attention the relations of the two corporations and to seek its judgment and direction in the collection of the assets of the bankrupt.

If the Smelting Company is merely an adjunct of the Copper Company, it is immaterial what the terms of the contract for the Smelting of ores would import if entered into by parties fully authorized to contract. The whole arrangement would crumble at the touch of the law and the acts done by the Smelting Company would stand forth as the acts and doings of the Copper Company and the nominal assets of the Smelting Company would manifestly be the property of the parent company.

If the Copper Company, by the fiction of the separate corporate existence of the Smelting Company has allowed persons to trade with it as a separate entity, it may be that so far as these creditors are concerned the Copper Company is estopped to deny that the nominal assets of the Smelting Company shall be first used to pay the debts incurred by that company and that in order to obtain the assets of the Smelting Company it must first pay its debts, but this result is reached by way of estoppel and not because the Smelting Company had

any existence as a separate company. The Copper Company's creditors may be bound to subordinate their claims to prior equities of the creditors of the Smelting Company, so far as the nominal assets of that company are concerned, and the appellee may be in no better fix, but such fact does not prevent either the Copper Company or the appellee from establishing the truth as to the relations between the two corporations or oppose an obstacle to the legal consequences which flow from such a state of facts. The transfer of the stock to the mortgages as additional collateral was accepted by them with a full knowledge of all the consequences and with the facts on record as to the relations of the parties and they got no other or higher title than the Copper Company had at the time of the transfer, and there is no dispute that the smelting of the ore which produced the flue dust and slag dump was all done long before any title to the stock was acquired by the pledgees.

These quotations as to the effect of such a holding are to a large extent academic in this case. The question in this case is **solely whether the slag dump and flue dust belong to the estate of the Copper Company.** If there is no legal existence in the Smelting Company because it is simply an adjunct of the Copper Company, then all of its nominal assets belong to that company. If it be a separate and legal corporation and the contract in regard to the erection of the plant of the Smelting Company and the smelting of the ores of the Copper Company is a binding contract, then the contract is a

bailment and the flue dust and slag still belong to the Copper Company.

We also call the Court's attention to the following late decisions:

Decided April 27, 1916, by the Circuit Court of Appeals of the 8th Circuit. Chicago Mill & Lumber Co. vs. Boatman's Bank, 234 Federal (Advance Sheets), page 41, wherein the court said:

"It is true, that, apart from the question of ultra vires, not presently involved, when one corporation owns or controls the entire property of another, and operates its plant and conducts its business as a department of its own business, or as its alter ego, it is responsible for its obligations incurred in so doing. American National Bank vs. National Wall Paper Co., 23 CCA 33, 77 Fed. 85; Westinghouse Electric & Manufacturing Co., vs. Allis Chalmers Co., 100 CCA 408, 176 Fed. 362; Phillips vs. Railroad, 211 Mo. 419, 438, 111 S. W. 109, 17 L. R. A. (N. S.) 1167, 124 Am. St. Rep. 786, 14 Ann. Cas. 742; Union Savings & Trust Co. vs. Krumm (Wash.) 152 Pac. 681.

United States vs. United Shoe Machinery Co., et al, decided June 6, 1916, by the District Court for the Eastern District of Missouri, 234 Federal Reporter (Advance Sheets) page 127, from the opinion in which case we cite the following:

"Whatever may have been the views of the courts in the early days of corporate existence, when there

were but few corporations, and they mostly confined to business of quasi public nature, at this date courts, and especially courts of equity, will look behind the corporate fiction, and if it clearly appears that one corporation is merely a creature of another, the latter holding all of the stock of the former, thereby controlling it as effectively as it does itself, it will be treated as the practical owner of the corporation, when necessary for the purpose of doing justice. In McCaskill vs. United States, 216 U. S. 504, 514, 30 Sup. Ct. 386, 391 (54 L Ed 590), Mr. Justice McKenna, delivering the opinion of the court said:

'Undoubtedly a corporation is, in law, a person or entity distinct from its stockholders and officers. It may have interest distinct from theirs. Their interests, it may be conceived, may be adverse to its interest, and hence has arisen against the presumption that their knowledge is its knowledge the counter presumption that in transactions with it, when their interest is adverse, their knowledge will not be attributed to it. But while this presumption should be enforced to protect the corporation, it should not be carried so far as to enable the corporation to become a means of fraud or a means to evade its responsibilities. A growing tendency is therefore exhibited in the courts to look beyond the corporate form to the purpose of it, and to the officers who are identified with that purpose. Illustrations are given of this in Cook on Corporations, Secs. 663, 664, 727. The Principle was enforced in this court in Simmons Creek

Coal Co. vs. Doran, 142 U. S. 417 (12 Sup. Ct. 239, 35 L. Ed. 1063).'

"The same rule was recognized in Linn & Lane Timber Co. vs. United States, 236 U. S. 574, 35 Sup. Ct. 440, 59 L Ed 725."

"From the allegations in the complaint it is beyond question, that the Maine Company is merely a subsidiary of the New Jersey Company, and that both are under the absolute control, by reason of its stock ownership, of the New Jersey Corporation. The acts of one are the acts of all these corporations; in fact, it may truthfully be said that they are the acts of the United Shoe Machinery Corporation. This being the case, they are properly joined as defendants."

In either aspect of the case, whether the Smelting Company is an instrumentality or a separate corporation, the decree of the court below is correct and it should be affirmed.

Respectfully submitted,

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